

Message Text

CONFIDENTIAL POSS DUPE

PAGE 01 TEL AV 01839 01 OF 02 291238Z

51

ACTION NEA-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-07 PA-04 RSC-01 PRS-01 SPC-03 SS-20

USIA-15 EB-11 OMB-01 TRSE-00 FRB-02 AID-20 SIL-01

LAB-06 COME-00 DRC-01 /129 W
----- 009235

R 291052Z MAR 74

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 1995

INFO AMCONSUL JERUSALEM

C O N F I D E N T I A L SECTION 1 OF 2 TEL AVIV 1839

E.O. 11652: GDS

TAGS: ECON, IS

SUBJ: DEBATE ON ECONOMIC FUNDAMENTALS

REF: TEL AVIV 1561

1. SUMMARY. PUBLIC DEBATE IS CURRENTLY TAKING PLACE ON FUNDAMENTAL ECONOMIC ISSUES--RISK OF RECESSION AGAINST OBVIOUSLY ACCELERATING INFLATION--BETWEEN FINANCE MINISTRY AND BANK OF ISRAEL (BOI). QUARREL HAS BECOME PERSONALIZED BETWEEN FINANCE MINISTER SAPIR AND HIS FORMER PROTEGE BOI GOVERNOR SANBAR, WITH UNPLEASANT OVERTONES. BOI IS ATTACKING ON BROAD FRONT, ARGUING FOR MORE RESTRICTIVE FISCAL POLICY IN SEVERAL AREA IN ORDER TO CURB INFLATION, WHICH WE NOW FEAR COULD REACH 40 PERCENT IN 1974. MUCH OF BOI'S ARGUMENT IS FOCUSSED ON ADVERSE EFFECT ON BALANCE OF PAYMENTS OF INFLATION AT THIS LEVEL AND CONSEQUENT THREAT OF RUNNING DOWN ISRAEL'S FOREIGN EXCHANGE RESERVES. IN REPLY, FINANCE MINISTRY POINTS TO RISK THAT MORE RESTRICTIVE POLICY WILL CAUSE DEFLATION WHICH WOULD DEGENERATE INTO RECESSION, WITH ALL THIS CONNOTES FOR UNEMPLOYMENT, AND DISCOURAGEMENT OF IMMIGRATION. SAPIR ANGRILY DENOUNCED CRITICISM AS SLANDEROUS, AND CITED ALTERNATIVE FOREIGN EXCHANGE RESOURCES WHICH ISRAEL COULD TAP IN A PINCH. MOREOVER, SAPIR HAS IN MIND POLITICAL CONSEQUENCES OF FURTHER BELT-TIGHTENING AND POSSIBLE RECESSION IN TERMS OF FURTHER EROSION OF ELECTORAL SUPPORT TO LIKUD; IT

CONFIDENTIAL
CONFIDENTIAL

PAGE 02 TEL AV 01839 01 OF 02 291238Z

QUENCES OF FURTHER BELT-TIGHTENING AND POSSIBLE RECESSION
IN TERMS OF FURTHER EROSION OF ELECTORAL SUPPORT TO LIKUD; IT

COULD ALSO DAMAGE HIS CHANCES OF SUCCEEDING TO PRIME MINISTERSHIP. FROM USG'S POINT OF VIEW, SANBAR'S POLICY OF CURBING INFLATION IS PREFERABLE, SINCE IT WILL MEAN LOWER LEVEL OF "NEED" (IN SOME SENSE) FOR USG ASSISTANCE. SAPIR, HOWEVER, MUST TAKE POLITICAL FACTORS INTO ACCOUNT, AND IS ALSO MORE SANGUINE ABOUT PROSPECTS FOR FOREIGN ASSISTANCE THAN SANBAR, AND THIS INFLUENCES HIS POLICY. END SUMMARY.

2. PUBLIC DEBATE OVER WHAT DIRECTION ECONOMIC POLICY SHOULD TAKE IS SHARPENING. BANK OF ISRAEL IS ATTACKER, ARGUING THAT GOVT POLICY DOES NOT SUFFICIENTLY TAKE ACCOUNT OF DANGERS OF INFLATION; THAT INTEREST RATES SHOULD BE RAISED; AND THAT GOVT BUDGET PROPOSED FOR FY 1974/75 (REFTEL) IS TOO LARGE AND SHOULD BE CUT. MINISTRY OF FINANCE TAKES CONTRARY POSITION THAT INFLATION IS CONTROLLABLE, AND THAT BIGGEST RISK IS THAT OF SERIOUS DEFLATION LEADING TO RECESSION, WITH ALL THAT CONNOTES. ACADEMIC ECONOMISTS OF NOTE APPEAR TO BE DIVIDED.

3. BOI GOVERNOR MOSHE SANBAR HAS LONG SINCE STRAINED HIS RELATIONS WITH HIS FORMER MENTOR, FINANCE MINISTER PINHAS SAPIR. HE CALLED FOR MORE RESTRICTIVE FISCAL POLICY ON SEVERAL OCCASIONS DURING 1973, AND AFTER A QUIESCENT PERIOD DUE TO WAR HAS AGAIN BEEN SPEAKING OUT. APPEARING ON TELEVISION OVER LAST WEEKEND HE RECOMMENDED THAT IL 1.5 BILLION BE CUT FROM PROPOSED GOVT BUDGET IN COMING YEAR ON GROUNDS IT WAS INFLATIONARY. DIRECTOR OF BOI'S RESEARCH DEPT (SUSSMAN), WHEN ASKED TO COMMENT, TOOK POSITION THAT SANBAR'S PROPOSED CUTS WERE NOT ENOUGH. PROF MICHAELY OF HEBREW UNIVERSITY RECOMMENDED IL 2.0 BILLION REDUCTION IN FISCAL IMPACT--IL 0.5 BILLION IN REDUCED SPENDING AND IL 1.5 BILLION IN INCREASED TAXES. FORMER BOI GOVERNOR HOROWITZ SUPPORTED THIS VIEW, POINTING TO EXCESS LIQUIDITY IN ECONOMY AS DEMONSTRATED BY BOOM IN REAL ESTATE SALES AND PURCHASES OF CONSUMER DURABLES. FINALLY, DIRECTOR GENERAL OF BOI, DR SHEFFER, HAS CRITICIZED GOI POLICY OF BORROWING FROM PUBLIC AT 30-35 PERCENT INTEREST (BY SELLING BONDS LINKED TO CONSUMER PRICE INDEX), WHILE SUBSIDIZING LOANS TO INVESTORS AT 6.5-9 PERCENT; FINANCE MINISTRY'S REACTION WAS PREDICTABLY SOUR.

CONFIDENTIAL

CONFIDENTIAL

PAGE 03 TEL AV 01839 01 OF 02 291238Z

4. FINANCE MINISTRY SPOKESMEN JUSTIFY THEIR APPROACH BY CITING ASSESSMENT THAT FAILURE TO ADOPT EXPANSIONARY POLICY RUNS RISK THAT DEFLATION WILL OCCUR, LEADING TO RECESSION. (RECESSION WOULD DISCOURAGE IMMIGRATION AS WELL AS INVESTMENT, AND THROW PEOPLE OUT OF W
E E E E E E E

ADP000

CONFIDENTIAL

PAGE 01 TEL AV 01839 02 OF 02 291300Z

51

ACTION NEA-12

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-07 H-03 INR-10 L-03

NSAE-00 NSC-07 PA-04 RSC-01 PRS-01 SPC-03 SS-20

USIA-15 EB-11 OMB-01 TRSE-00 FRB-02 AID-20 SIL-01

LAB-06 COME-00 DRC-01 /129 W

----- 009325

R 291052Z MAR 74

FM AMEMBASSY TEL AVIV

TO SECSTATE WASHDC 1996

INFO AMCONSUL JERUSALEM

C O N F I D E N T I A L SECTION 2 OF 2 TEL AVIV 1839

6. IN ANGRY STATEMENT TO KNESSET ON MARCH 25, SAPIR BALSTED HIS CRITICS, ESPECIALLY SANBAR, ACCUSING THEM OF AROUSING PANIC AMONG PUBLIC BY TALK OF DECLINE IN RESERVES. PRESS QUOTES SAPIR AS SAYING: "THEY ARE SPREADING STORIES WHICH ARE A FIGMENT OF THE IMAGINATION AND WHICH SERVE THE INTERESTS OF NEITHER THE COALITION NOR THE OPPOSITION. THEY ARE INDUCING A RUSH ON IMPORTS BECAUSE OF APPREHENSIONS ABOUT FUTURE CURRENCY RESERVES. WHAT SORT OF WAY IS THIS TO HELP STABILIZE PRICES? THEY ARE COMMITTING A TRANSGRESSION AGAINST THE STATE. THEIR TALK IS SLANDEROUS." SAPIR WENT ON TO POINT OUT FOREIGN DEBT WAS ON FAVORABLE TERMS, WITH OVER 95 PERCENT ON LONG- OR MEDIUM-TERM, MANY WITH 15, 20, AND 30-YEAR MATURITIES. AS FOR RESERVES, SAPIR NOTED THAT BESIDES OFFICIAL RESERVES ISRAEL COULD DRAW UPON OTHER RESOURCES, SUCH AS \$900 MILLION IN FOREIGN RESIDENTS DEPOSITS, \$600 MILLION AVAILABLE IN CREDITS, AS WELL AS SMALLER AMOUNTS OF FOREIGN CURRENCY GIVEN TO COMMERCIAL BANKS FOR THEIR OVERSEAS OPERATIONS, AND GOI COULD EVEN USE FOREIGN SECURITIES OWNED BY ISRAEL RESIDENTS AS IT HAD DURING 1952-53 CRISIS. (COMMENT: SAPIR'S CATALOG OF "OTHER RESOURCES" INDICATES JUST HOW CLOSE TO THE BONE HIS CRITICS HAVE COME.)

7. THERE IS MERIT IN BOTH SIDES OF CONTROVERSY. PROBLEM IS

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 TEL AV 01839 02 OF 02 291300Z

WHERE TO STRIKE BALANCE BETWEEN TWO OBJECTIVES OF FULL EMPLOYMENT AND MINIMIZING BOP DEFICIT. FROM USG POINT OF VIEW, SANBAR APPROACH WILL RESULT IN LESS "NEED" (IN SOME SENSE) FOR FOREIGN AID THAN SAPIR'S LINE. SAPIR'S POLICY REFLECTS HIS EXPECTATIONS AND HOPES ABOUT FOREIGN FUND RAISING, ESPECIALLY FROM USG, WHICH ARE MORE SANGUINE THAN SANBAR'S. MOREOVER, AS IS TRUE IN MOST

COUNTRIES, CENTRAL BANK IS MORE UPSET ABOUT INFLATION THAN FINANCE MINISTRY, WHICH HAS TO WEIGHT POLITICAL CONSIDERATIONS.

8. FINANCE MINISTER SAPIR AND HIS AIDES HAVE TOLD US THAT IF INFLATION GETS ROLLING FASTER THAN EXPECTED GOI HAS SEVERAL COUNTER MEASURES IT CAN EMPLOY. VALUE-ADDED TAX IS ONE, BUT IT HAS DIS-ADVANTAGE OF ITSELF STIMULATING INFLATION; ALTERNATIVE IS PURCHASE TAX INCREASE. ANOTHER POSSIBILITY IS DEVALUATION, WHICH WOULD DISCOURAGE IMPORTS. HOWEVER, WHILE DEVALUATION IS INEVITABLE SOMETIME, IT IS DANGEROUS DURING INFLATIONARY PERIOD AS IT WOULD ALSO BOOST INFLATION; MORE LIKELY IS QUASIDEVALUATION UNDERTAKEN THROUGH INCREASE OF GENERAL IMPORT SURCHARGE (NOW 25 PERCENT) TO 30 OR 35 PERCENT.

9. SAPIR'S PERSONAL POSITION IS ALSO FACTOR; HE TOOK BLAME FOR 1965-67 RECESSION (WHEN GOI SLAMMED ON BRAKES TOO HARD) AND HE IS UNWILLING TO DO SO AGAIN. IF HE STILL HARBORS HOPES OF SUCCEEDING TO PRIME MINISTERSHIP (A DEBATED ISSUE), ANOTHER RECESSION WOULD PRESUMABLY FINISH THEM.

10. HOWEVER, BIGGEST QUESTION OF ALL IS WHERE ECONOMY GOES FROM HERE. NATIONAL WAGE NEGOTIATIONS, DUE TO START IN NEAR FUTURE, WILL FURNISH SOME CLUES. GOI INTENDS TO APPEAL TO WORKERS TO FOREGO ANY BASIC WAGE INCREASE DURING COMING YEAR, AND BE CONTENT WITH ONLY COST-OF-LIVING INCREASE. IN RETURN, SAPIR IS WILLING TO FREEZE PRICES OF ESSENTIAL COMMODITIES AT CURRENT LEVEL (TEL AVIV A-52, MARCH 19). NEGOTIATIONS ON WAGES WILL PROBABLY DRAG ON FOR SEVERAL MONTHS BEFORE OUTCOME IS CLEAR. IN THIS CONNECTION, FINANCE MINISTRY'S IRRITATION WITH DR SHEFFER'S CRITICISM ON INTEREST RATES (PARA 3) IS RELATED TO REVELATION OF BOI FORECAST OF INFLATION DURING 1974 (30-35 PERCENT), WHICH CAN ONLY AGGRAVATE WAGE DEMANDS. IF INFLATION REACHES 4
E E E E E E E

Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: INFLATION, FINANCIAL DATA, GOVERNMENT DEBTS, FOREIGN EXCHANGE HOLDINGS, ECONOMIC PROGRAMS
Control Number: n/a
Copy: SINGLE
Draft Date: 29 MAR 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: golinofr
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974TELAV01839
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D740069-0317
From: TEL AVIV
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t1974032/aaaaabxf.tel
Line Count: 196
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION NEA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: TEL AVIV 1561
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags: ANOMALY
Review Date: 20 AUG 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <20 AUG 2002 by elyme>; APPROVED <08 JAN 2003 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: DEBATE ON ECONOMIC FUNDAMENTALS
TAGS: ECON, IS, (SANBAR)
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005